Internal Revenue Service

Number: **201648013**
Release Date: 11/25/2016

Index Number: 1031.00-00, 1031.05-00, 1031.07-00

Department of the Treasury
Washington, DC 20224

[Third Party Communication:
Date of Communication: Month DD, YYYY]

Person To Contact:
, ID No.

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Refer Reply To:
CC:ITA:B05
PLR-116116-16

Date:
August 15, 2016

TY:

Legend

Taxpayer	=
State A	=
Tax Year	=
QI	=
Parent	=
Trust	= .
Properties	=
Borrower	=
Servicer	=
Collateral Trustee	=
Administrative Agent	=
Property	=

Dear :

This letter responds to a request for a private letter ruling dated May 16, 2016, and supplemented on July 5, 2016, filed by your authorized representative on behalf of the above-referenced Taxpayer. Two rulings have been requested under § 1031 of the Internal Revenue Code (Code): (i) For purposes of § 1.1031(k)-1 of the Income Tax Regulations (regulations), Taxpayer will not have actual or constructive receipt of Relinquished Property Proceeds (defined below) where, pursuant to the terms of the Master Exchange Agreement ("MEA") and the Loan and Security Agreement ("LSA"), QI, a qualified intermediary, must use such Proceeds to repay Loans secured by the

relinquished property; and (ii) QI's repayment of Relinquished Property Debt (defined below) with Relinquished Property Proceeds will be treated as liability relief for purposes of the boot netting rules under § 1.1031(b)-1(c).

FACTS

Taxpayer's principal place of business is located in State A. Taxpayer files income tax returns on a calendar year basis, and uses the accrual method of accounting. Taxpayer is primarily engaged in the business of providing loans and leases to consumers of Properties. Taxpayer represents that it is the tax owner of the leased Properties for federal income tax purposes.

In Tax Year, Taxpayer implemented a Like-Kind Exchange Program (LKE Program) pursuant to the LKE Program safe harbor rules in Rev. Proc. 2003-39, 2003-1 C.B. 971, for the purpose of engaging in like-kind exchanges involving the leased Properties under § 1031 and §1.1031(k)-1. Taxpayer entered into the MEA with QI as the qualified intermediary. QI is a wholly owned subsidiary of Parent. Taxpayer represents that neither QI nor Parent is a disqualified person under § 1.1031(k)-1(k).

Taxpayer finances its Properties leasing business with funds borrowed from unrelated, third-party lenders ("Lenders"). The financings are made pursuant to various lending arrangements ("Loans"), which are used exclusively by Taxpayer to purchase new Properties for use in Taxpayer's leased Properties business. Each Loan is secured by a pool of separately identified Properties as well as each Property's associated lease contract and related lease and residual income stream.

Taxpayer is negotiating LSA with Lenders. LSA is expected to be finalized subject to certain negotiated changes that are not expected to make material changes to the rulings being requested here. Article , Section – Collection, Allocation and Distribution of Sales Proceeds and Article , Section – Grant of Security Interest of the LSA are relevant to the issue of whether for purposes of the liability netting rules under § 1031, Loans are secured by relinquished Properties, and any proceeds from the disposition of relinquished Properties ("Relinquished Property Proceeds") must be used to repay Loans.

Taxpayer has established Trust, a Delaware business trust, to act as titling trust and the entity that holds record ownership and title of all of Taxpayer's United States Properties and related leases originated by Taxpayer. Taxpayer is grantor and sole beneficiary of Trust, as well as initial beneficiary of certain "special units of beneficial interest ("SUBI"), representing tax ownership of Properties as an undivided trust interest in each Property, the related leases, and the associated cash flows.

Taxpayer uses a titling trust structure to avoid the cost and administrative burden of transferring actual title to Lenders or their agent (Collateral Trustee), including certain

retitling and tax costs upon each transfer. Pursuant to its lending arrangements, Taxpayer transfers its beneficial interest in the SUBI to the Collateral Trustee as collateral for its Loans rather than actual title to each Property. The LSA provides that to secure timely payment of amounts loaned ("Advance Amounts") and all obligations owing by the Borrower, as part of collateral for the Loans, the Borrower conveys, warrants, assigns, transfers, pledges, and grants a security interest in the "Financial SUBI" (which, as Collateral for Loans, includes the relinquished Properties) to the Collateral Trustee. This provision grants Lenders a security interest in Taxpayer's relinquished Properties including all collections of exchange/sales proceeds received from the disposition of relinquished Properties. Article , § provides:

> To secure the timely payment of the Advance Amount and all obligations by the Borrower related thereto and the performance and observance of all obligations and liabilities of the Borrower incurred under this Agreement and the other Transaction Documents (collectively, the "Obligations"), the Borrower hereby conveys, warrants, assigns, transfers, pledges and grants a security interest unto the Collateral Trustee, for the ratable benefit and security of the Secured Parties, in all right, title, interest, claims and demands of the Borrower, wherever located, whether now or hereafter existing, owned or acquired in, to or under the Financed SUBI, the Financed SUBI Certificate (including all Collections received thereunder …).

Taxpayer has been appointed "Servicer" in accordance with the LSA and will perform administrative and customer service activities related to Properties securing the LSA, which will include collection of Property lease payments and sales proceeds. Collections of cash proceeds from the sale of relinquished Properties will be deposited directly into a Joint Collection Account ("JCA") consistent with section 5.02 of Rev. Proc. 2003-39. Article , § of the LSA provides:

> Collections will be received into a lockbox account into which unrelated funds may be deposited. Collections may be commingled with other funds and need not be segregated in a separate account prior to the deposit of such Collections into the Collection Account. It is understood that Collection of proceeds from the disposition of [leased Properties] received in the lockbox account and deposited and held in the Collections Account will be held under the direction and control of a Qualified Intermediary or will be held in a Qualified Intermediary Account and to the extent such [Properties] constituted Collateral at the time of disposition and the extent such proceeds must be used to repay the LSA, such amounts shall constitute Collateral.

The term "Collections" above includes any proceeds generated from the disposition of relinquished Properties and the term "Financed [Property]" includes any relinquished Properties securing the Loan.

The LSA further requires that any proceeds from the sale of Collateral, including the sale of relinquished Properties securing Loans, must be used to repay the Loans. Article , § of the LSA provides:

> On each Business Day, Sales Proceeds received in connection with the sale or other disposition of a Financed [Property] which is Collateral under this Loan and Security Agreement must first be used to repay any outstanding balance due pursuant to any secured revolving credit facility constituting a Loan Related Loan Agreement under this Agreement and then shall immediately be used to repay any other outstanding balance due pursuant to Section .

Loans are structured to facilitate turnover in the pool of Properties securing the Loans while at the same time maintaining the net overall level of borrowing. If Taxpayer is required to apply Property disposition proceeds to repay the LSA, Taxpayer typically re-borrows amounts from the LSA to fund new Property purchases, which then replace disposed Properties as Collateral for the LSA.

Under the MEA, Taxpayer disposes of leased Properties subject to the above Loans and the proceeds from such dispositions are deposited directly with QI. Article , § of the MEA provides:

> All Relinquished Property Proceeds, Non-Qualified Proceeds and Additional Subsidies shall be held subject to the terms of this Agreement. In particular, All Relinquished Property Proceeds (and any earnings thereon) shall be held Subject to Treasury Regulations Sections 1.1031(k)-1(g)(4)(ii) and (g)(6). Without limiting the foregoing, [Taxpayer's] right to receive, pledge, borrow, or otherwise obtain the benefits of any Relinquished Property Proceeds (whether in the form of money or other property) and any earnings thereon are expressly limited as provided in Treasury Regulations Sections 1.1031(k)-1(g)(4)(ii) and 1.1031(k)-1(g)(6); and, with respect to each Exchange, [Taxpayer] shall have no right, except as provided in paragraphs (g)(6)(ii) and (g)(6)(iii) of Treasury Regulation Section 1.1031(k)-1, to receive, pledge, borrow, or otherwise obtain the benefits of the money or other property related to such Exchange before the occurrence of a Distribution Event for such Exchange. All funds held in the Collection Accounts, the Exchange Account, and the Disbursement Accounts shall be subject to such restrictions as are necessary for such Accounts to satisfy the Safe Harbors under Sections 5.02 and 5.03 of Rev. Proc. 2003-39.

To the extent Properties disposed of secure Loans and to the extent Loans require it, the MEA requires that QI repay the respective Loans directly out of the JCA or by directing that payment be made directly to Collateral Agent. Article , § of MEA:

> The parties to this Agreement acknowledge and agree that the Exchangor shall be permitted to transfer Relinquished Property Subject to Liabilities. If

> the Exchangor transfers Relinquished Property Subject to Liabilities pursuant to Section hereof, then [QI] shall, in accordance with the procedures set forth in section 4.02 hereof, repay the liabilities required to be repaid with the sale proceeds of such Relinquished Property; provided; however, that if the amount to be paid in respect of such liabilities as a result of the disposition of such Relinquished Property Subject to Liabilities is greater than the proceeds received from the sale of such Relinquished Property Subject to Liabilities, then [Taxpayer] shall remain obligated to make payment of such excess amount directly to the holder of such liability to the extent set forth in, and in accordance with the terms of, the applicable Financing Documentation.

The term "Relinquished Property Subject to Liabilities" is defined as "any Relinquished Property that is subject to (i) a requirement or obligation that debt or other financial accommodations secured or supported by such Relinquished Property must be repaid as a result of such Relinquished Property being transferred, or (ii) a requirement that the sale proceeds from the disposition of such Relinquished Property be applied to satisfy the debt or other financial accommodations secured or supported by such Relinquished Property." Article , § of the MEA.

Taxpayer represents that it and QI intend to treat exchange proceeds received by QI from "Relinquished Property Subject to Liabilities" as relief of liabilities to be offset against consideration given by the Exchanger in the form of cash or Replacement Property Debt as provided in § 1.1031(b)-1(c).

Under the MEA and the LSA, a transfer of old Properties to third party buyers and the requirement to repay the Loans are interdependent, that is, a Property cannot be transferred to a buyer without QI making a debt repayment equal to the lesser of any outstanding balances on Loan or the amount of Relinquished Property Proceeds received by QI for such transfer.

When Taxpayer wants to purchase new Properties, Taxpayer deposits cash obtained either from new Loan borrowings or other sources with QI to fund QI's acquisition of new Properties. New Properties may be matched by Taxpayer for purposes of completing an exchange of old and new Properties. Any new Properties purchased by QI with funds borrowed from Loans become security for Loans and are then subject to the same disposition and Loan repayment requirements.

Taxpayer represents that its LKE program otherwise meets the requirements for like-kind exchange treatment under § 1031, including the requirements for deferred exchanges under § 1.1031(k)-1 and Rev. Proc. 2003-39.

LAW AND ANALYSIS

Section 1031(a)(1) of the Code provides that no gain or loss shall be recognized on the exchange of property for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.

Section 1031(b) provides, in part, that in an exchange that would be within the provisions of § 1031(a) if it were not for the fact that the property received in the exchange consists not only of property permitted to be received without recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized but in an amount not in excess of the sum of such money and the fair market value of such other property.

Section 1.1031(b)-1(c) of the Regulations provides that consideration in the form of an assumption of liabilities (or a transfer subject to a liability) is to be treated as "other property or money" for the purposes of § 1031(b). Where, in an exchange described in § 1031(b), each party either assumes a liability of the other party or acquires property subject to a liability, then, in determining the amount of other property or money, consideration given in the form of an assumption of liabilities (or the receipt of property subject to a liability) is offset against consideration received in the form of an assumption of liability (or transfer subject to a liability). Thus, when there are mortgages on both sides of the transaction, the mortgages are netted and the difference becomes recognized gain (boot) to the party transferring the property with the larger mortgage. See also § 1.1031(d)-2, Examples (1) and (2).

Section 1.1031(j)-1(b)(2)(II)(A) provides that all liabilities assumed by the taxpayer as part of the exchange are offset against all liabilities of which the taxpayer is relieved as part of the exchange, regardless of whether the liabilities are recourse or nonrecourse and regardless of whether the liabilities are secured by or otherwise relate to specific property transferred or received as part of the exchange. §§ 1.1031(b)-1(c) and 1.1031(d)-2.

In Example (5) of § 1.1031(k)-1(j)(3), the transferor, B, of relinquished property in a deferred exchange transfers property that is encumbered with a $30,000 mortgage to the transferee, C, on May 17, 1991. C assumes the mortgage on that date. On July 15, 1991, B receives the replacement property and assumes a $20,000 mortgage encumbering the replacement property. The consideration received by B in the form of the liability assumed by C ($30,000) is offset by the consideration given by B in the form of the liability assumed by B ($20,000). The excess of the liability assumed by C over the liability assumed by B, $10,000, is treated as "money or other property." Thus, B recognizes gain under § 1031(b) in the amount of $10,000.

Section 1.1031(k)-1(f)(1) provides, in part, that in the case of a transfer of relinquished property in a deferred exchange, gain or loss may be recognized if the taxpayer actually or constructively receives money or other property before the taxpayer actually receives

like-kind replacement property. If the taxpayer actually or constructively receives money or other property in the full amount of the consideration for the relinquished property before the taxpayer actually receives the like-kind replacement property, the transaction will constitute a sale and not a deferred exchange even though the taxpayer may ultimately receive like-kind replacement property.

Section 1.1031(k)-1(f)(2) provides that, except as provided in paragraph (g) of this section (relating to safe harbors), for purposes of § 1031 and this section, the determination of whether (or the extent to which) the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property is made under the general rules concerning actual or constructive receipt and without regard to the taxpayer's method of accounting. The taxpayer is in actual receipt of money or property at the time the taxpayer actually receives the money or property or receives the economic benefit of the money or property. The taxpayer is in constructive receipt of money or property at the time the money or property is credited to the taxpayer's account, set apart for the taxpayer, or otherwise made available so that the taxpayer may draw upon it at any time or so that the taxpayer can draw upon it if notice of intention to draw is given. Although the taxpayer is not in constructive receipt of money or property if the taxpayer's control of its receipt is subject to substantial limitations or restrictions, the taxpayer is in constructive receipt of the money or property at the time the limitations or restrictions lapse, expire, or are waived. In addition, actual or constructive receipt of money or property by an agent of the taxpayer (determined without regard to paragraph (k) of this section) is actual or constructive receipt by the taxpayer.

Section 1.1031(k)-1(g)(4)(i) provides that in the case of a taxpayer's transfer of relinquished property involving a qualified intermediary, the qualified intermediary is not considered the agent of the taxpayer for purposes of § 1031(a). In such a case, the taxpayer's transfer of relinquished property and subsequent receipt of like-kind replacement property is treated as an exchange and the determination of whether the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property is made as if the qualified intermediary is not the agent of the taxpayer. Paragraph (g)(4)(ii) states that paragraph (g)(4)(i) applies only if the agreement between the taxpayer and the qualified intermediary expressly limits the rights of the taxpayer to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by the qualified intermediary as provided in § 1.1031(k)-1(g)(6).

Section 1.1031(k)-1(g)(4)(iii) provides, in part, that a qualified intermediary is a person who is not the taxpayer or a disqualified person (as defined in paragraph (k) of this section), and enters into a written agreement with the taxpayer (the "exchange agreement") and, as required by the exchange agreement, acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property, and transfers the replacement property to the taxpayer.

Section 1.1031(k)-1(g)(6)(i) provides that an exchange agreement limits a taxpayer's rights as provided in this paragraph (g)(6) only if the agreement provides that the taxpayer has no rights, except as provided in paragraphs (g)(6)(ii) and (g)(6)(iii) of this section, to receive, pledge, borrow, or otherwise obtain the benefits of money or other property before the end of the exchange period. Paragraph (g)(6)(ii) provides that the agreement may provide that if the taxpayer has not identified replacement property before the end of the identification period, the taxpayer may have rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property at any time after the end of the identification period. Paragraph (g)(6)(iii)(A) provides that the agreement may provide that if the taxpayer has identified replacement property, the taxpayer may have rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property after the receipt by the taxpayer of all the replacement property to which the taxpayer is entitled under the exchange agreement.

Section 5.02 of Rev. Proc. 2003-39 provides that a taxpayer engaged in a like-kind exchange program ("LKE Program") will not be considered in actual or constructive receipt of proceeds from the sale of relinquished property deposited into or held in a joint bank, trust, escrow, or similar account in the name of the taxpayer and the qualified intermediary, or in an account in the name of a third party (other than a disqualified person as defined in § 1.1031(k)-1(k)) for the benefit of both the taxpayer and the qualified intermediary, if:

(1) The account is used to collect, hold, and/or disburse proceeds arising from the sale of relinquished property for the benefit of the qualified intermediary;

(2) The agreement setting forth the terms and conditions with respect to the account requires authorization from the qualified intermediary to transfer proceeds from the sale of relinquished properties out of the account; and

(3) The agreement setting forth the terms of the taxpayer's and qualified intermediary's rights with respect to, or beneficial interest in, the account expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of proceeds from the sale of relinquished property held in the joint account as provided in § 1.1031(k)-1(g)(6).

Section 5.02 of Rev. Proc. 2002-39 further provides that the account may be used by the parties for other purposes provided that the other uses do not undermine a qualified intermediary's right to control the proceeds from the sale of relinquished property.

Section 5.03 of Rev. Proc. 2002-39 provides that a taxpayer engaged in an LKE Program will not be considered to be in actual or constructive receipt of money or other property as a result of transferring relinquished property solely because an amount owed by the taxpayer to the buyer (other than a lease security deposit) is netted against the sale price of the relinquished property, provided that, as required by the master

exchange agreement, funds equal to the full amount of sales proceeds from the relinquished property are transferred to or for the benefit of the qualified intermediary by the opening of the next day's business. Likewise, a taxpayer acquiring replacement property in a like-kind exchange will not be considered in actual or constructive receipt of money or other property solely because an amount owed by the seller to the taxpayer is netted against the purchase price of the property and the qualified intermediary transfers to the taxpayer funds in an amount equal to the amount owed by the seller to the taxpayer so that the qualified intermediary expends the full amount of the purchase price obligation for the replacement property.

In *Barker v. Commissioner*, 74 T.C. 555 (1980), the Tax Court held that proceeds from the disposition of the relinquished property can be used to pay off debt on the relinquished property without triggering gain if the taxpayer incurs or assumes a liability on the purchase of the replacement property that equals or exceeds the debt on the relinquished property. The taxpayer in *Barker* received cash in the exchange but was contractually obligated by the transferee of the relinquished property to use the cash to pay off the relinquished property debt. Thus, the Tax Court held that the boot netting principle in § 1.1031(b)-1(c) covers not just assumptions of debt but also situations in which the proceeds of the relinquished property are used to pay off the relinquished property debt.

With respect to Taxpayer's first ruling request, under the LSA, repayment of Loans with Relinquished Property Proceeds is required and the relinquished properties secure repayment of Loans. The full value of Taxpayer's Properties secures repayment of Loans, and the lending agreement requires that any proceeds generated from the disposition of the relinquished Properties securing the Loans must be deposited directly with QI or are directed by QI to pay the Loans and therefore must be used to repay any outstanding balances. As a result of QI acting as a conduit of the purchaser of the relinquished Property in receiving the cash proceeds from the disposition and using such proceeds to re-pay the outstanding liability on the relinquished Property, which is interdependent and related to the transfer of the relinquished Property to the buyer, the Taxpayer does not have actual or constructive receipt of the Relinquished Property Proceeds for purposes of § 1.1031(k)-1(g)(6).

With respect to Taxpayer's second ruling request, *Barker* supports the principle that the proceeds from the disposition of the relinquished property in a deferred exchange of property can be used to pay off the relinquished property debt and the debt repayment will be treated as an assumption of debt by the buyer of the relinquished property for purposes of the boot netting rules under § 1.1031(b)-1(c) even if there is no actual assumption of debt on the relinquished property by the buyer or transfer of the relinquished property to the buyer subject to such debt as in Example 5 of § 1.1031(k)-1(j)(3). Specifically, *Barker* concluded that the boot netting principle in that regulation

covers not just assumptions of debt but also situations in which the proceeds of the relinquished property are used to pay off debt secured by the relinquished property.[1]

CONCLUSIONS

We therefore conclude that for purposes of Treas. Reg. § 1.1031(k)-1, Taxpayer will not have actual or constructive receipt of Relinquished Property Proceeds where, pursuant to the terms of the MEA and the LSA, QI must use such Proceeds to repay Loans secured by the relinquished property. We further conclude that QI's repayment of Relinquished Property Debt with Relinquished Property Proceeds will be treated as liability relief for purposes of the boot netting rules under § 1.1031(b)-1(c).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Further, no opinion is expressed or implied concerning any terms of the MEA or the LSA not specifically restated in this letter affect any aspect of this ruling.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

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[1] The Service in CCA 201325011 (September 10, 2012) followed Barker and held that the use of the proceeds from the disposition of the relinquished property by a qualified intermediary to pay down the taxpayer's lines of credit, which were secured by the relinquished property, did not result in the taxpayer being in actual or constructive receipt of the relinquished property proceeds for purposes of section 1.1031(k)-1. In following Barker, the CCA also accepted the principle that the proceeds from the disposition of the relinquished property can be used by a qualified intermediary to pay off debt secured by the relinquished property, and that this debt repayment will be treated as an assumption of debt by the buyer of the relinquished property for purposes of the boot netting rules under section 1.1031(b)-1(c) even if there is not an actual assumption of debt on the relinquished property by the buyer or transfer of the relinquished property to the buyer subject to such debt as in Example 5 of section 1.1031(k)-1(j)(3).

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Christina M. Glendening
Senior Counsel, Branch 5
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosure (1)

cc: